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From:

Sent: Wednesday September 21, 2011 4:51 PM

To:

Cc:

Subject: Adoption credit possible statute of limitations issue

Re: Taxpayer:

Good afternoon,

This email follows up on our conversation today about the above taxpayer, the adoption tax credit, and the interplay of the statute of limitations with the 5-year carryforward of the adoption credit.

As we discussed, under former Internal Revenue Code section 23, the adoption credit was nonrefundable but had a 5-year carryforward. Thus, if an adoption were finalized in 2005 but the taxpayer had insufficient tax liability to absorb the full credit in that year, the credit could be carried forward for up to 5 years (with 2006 being the first year of the carryforward period and 2010 the fifth and final year).

The adoption credit was made refundable by statute for tax years 2010 and 2011 and was redesignated as section 36C. In Notice 2010-66, the Service determined that refundable-credit treatment also applies to qualified adoption expenses (QAE) properly carried forward into 2010. Thus, for an adoption finalized in 2005 or thereafter, there exists the potential of a refundable credit in 2010.

The taxpayer of whom we were speaking says: (a) she finalized the adoption of a child in ; (b) the child had been determined to have special needs by the State in which the adoption was finalized; (c) the taxpayer has supplied the Service with proof of that determination of special needs (via an adoption subsidy agreement); (d) she did not file a Form 8839, *Qualified Adoption Expenses*, for through until she filed amended returns for those years in and (e) she filed a Form 8839 for in which she claimed a refundable credit. I am assuming for purposes of this email that the above statements are correct and have been verified.

The amended returns for were filed after the statute of limitations for refunds (section 6511) had expired. You asked whether that expiration bars the carryforward into .

The answer is that the statute of limitations bars refunds from closed years, but that the Service must look to the time-barred years to determine the extent of any tax benefit the taxpayer could have received had she filed a timely claim. To the extent a tax benefit could have been received, the amount of any refund is permanently barred and the carryforward is reduced. However, to the extent no tax benefit could have been obtained through the filing of a timely claim for refund, the credit is carried forward to successive years.

Example: In 2005 the maximum adoption credit was \$10,630. Assume the taxpayer met all criteria for claiming the \$10,630 in 2005 except that her tax liability was only \$2,630. Because the credit was nonrefundable, it could have reduced her tax liability to zero, but not below. On these facts the taxpayer could have received a tax benefit of \$2,630 in 2005. Had the taxpayer filed a timely 2005 tax return, she would have used up the \$2,630 and would have been allowed to carry forward \$8,000 (\$10,630 maximum credit less \$2,630) to 2006.

Assume further that the taxpayer had \$1,000 of tax liability in 2006. Had she timely claimed the adoption credit in 2006, she would have received \$1,000 of tax benefit and her carryforward into 2007 would have been \$7,000 (\$8,000 carryforward into 2006 less \$1,000 allowable in 2006).

In this Example, the \$2,630 from 2005 and the \$1,000 from 2006 are forever barred to the taxpayer by the statute of limitations. She cannot obtain either a refund of those amounts, or any other form of tax benefit from them.

However, she amended her 2007 return before the statute of limitations on that year ran. On the facts of the Example, the taxpayer has \$7,000 of adoption carryforward that is available to be used in 2007, 2008, and 2009. Any amount of the \$7,000 that could not be used in 2007, 2008, and 2009 is available as a refundable credit in 2010 (assuming all other requirements for the credit were satisfied).

Suppose instead the taxpayer had no tax liability for any of the years 2005 through 2010. In this circumstance the taxpayer could not have received any tax benefit from any part of the \$10,630 in any of the nonrefundable years and would have carried forward the entire \$10,630. If all other requirements for the credit were satisfied, the taxpayer would be entitled to a refundable credit of \$10,630 in 2010.

Please let me know if I can be of further assistance.